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IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

ISAAC S. MORELAND,
Appellant,

vs.

J. SAM BROWN, as Receiver of the First National Bank of Helena,
Appellee.

APPELLEE'S BRIEF.

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ADDITIONAL STATEMENT.

The New York bank not only undertook that the $2,635 should be transmitted, but that it should be "paid" plaintiff. (p. 11, line 15.) It was neither transmitted nor paid, but, aside from the book entry credit, the money itself remained in the New York bank, and is still there, unless withdrawn by the Receiver's contract.

There was no privity between plaintiff and the Helena bank; it was not selected by plaintiff as his agent to receive, and had no connection with the

transaction, except as the New York bank itself passed this credit to it. At the time the New York bank telegraphed the order of payment it had no funds in the Helena bank. The New York bank is perfectly solvent; undisputedly plaintiff has a complete cause of action against it, so that he is in no danger of ultimate loss, while if he takes from the New York bank, the creditors of this bank do not suffer by a diminution of the trust assets. The $15,000 debt of the Helena to the New York bank was a distinct debt, entirely separate from the open account which showed the $11,000 credit balance at time of former suspension. It does not appear that there was in this open account *continuously* from and after Aug. 30th to Sept. 4th, a credit balance equal to or greater than $2,635. As to this contract, it is only charged that "for the purpose of redeeming such collateral" the Receiver paid the New York bank a sum, "to-wit, about $4,000; * * * * * and thereby procured the said collateral to be released and turned over" to him; and while it is averred that the sum paid over was equal to the difference between the collateral debt and the credit balance in the deposit account (p. 13, 14), it is not alleged that the $15,000 debt was fully paid or the credit balance extinguished—merely that the collateral was released and turned over. It is not alleged that either the Receiver when he bargained, or the Comptroller when he authorized, the contract, to pay $4,000 of the trust moneys to release the collateral, *knew* that

the $11,000 credit balance in the New York bank contained plaintiff's $2,645, or that they knew anything about the credit balance at all. So far as appears, the New York bank may have written and offered to surrender its lien on that collateral for a fixed sum named by it. which it may have arrived at in its own way, and the Receiver may have accepted the offer and paid the money asked and taken the collateral; and so the credit balance may never have been spoken of by either party in making this contract, so far as any allegation in the pleading is concerned.

The *actual* value of the collateral is not averred.

It is not charged that the belief of the New York bank that the Helena bank had paid plaintiff was the *moving* cause of its making the contract of release; or that but for such belief it would not have taken the $4,000 of the Receiver or released the collateral; or that this mistake of fact was without negligence on its part. The original and amended complaint are substantially alike, except that paragraph VI. of amended, was not in the original complaint. But there was an utter change in the theory of the nature of plaintiff's right, the former asking for a direct judgment for $2,635 against the Receiver; the latter only asking for a lien on the collateral in his hands.

ARGUMENT.

Plaintiff justifies his right to the relief asked

on two grounds: I. Subrogation; II. Right to follow trust funds.

I.

(*a*) Subrogation, as applied to this case, will be the right of Moreland, having a claim against the New York bank, to step into the bank's shoes and avail himself of, and enforce, any claim held by it as indemnity to itself against its obligation to plaintiff.

Sheldon, Subrogation, 2d Ed., Sec. 1.

By the acceptance of the deposit on the terms conferred, it became bound to transmit and pay; and this was its liability. The right to demand this was Moreland's claim. It must not be for a moment forgotten that under this principle of subrogation, wherever it is applicable, the person claiming it can assert no greater right than belonged to the one to whose rights he is subrogated, and it must further be remembered that the burden is on the plaintiff to show such a condition as clearly entitles him to the right.

Sheldon, Subrogation, 2d Ed., p. 16.

What right, then, had the New York bank, as against the Helena bank or its Receiver, before or after the collateral release contract? Before the contract it had the money in its own possession; it had given a mere paper credit to induce the First National to pay, which it could have annulled and erased on its books at any time. This credit was

its own obligation to pay the Helena bank; and, if availed of by subrogation, would have meant merely a right in plaintiff to compel the New York bank to pay the amount credited.

Its refusal to pay plaintiff on the wire order, which was in effect a telegraphic draft, gave no right of action to the New York bank against the Helena bank, because the former at the time of the order had no money on deposit in the latter, and the latter was not bound to pay.

> National Machinery Bank vs. Peck, 127 Mass., 298.
>
> 3 Am. & Eng. Enc. of Law, p. 225.

Nor would this telegraphic order or draft, or a formal draft, even if an equal amount had actually been on deposit in the Helena bank to the New York bank's credit, have constituted an equitable assignment, so as, under principles of subrogation, to have entitled plaintiff to claim priority in the assets of the Helena bank against other creditors.

> Bank vs. Yardley, 165 U. S., 643, foot, 644 top. (41 Co-Op. Ed., 861, middle).

It had no claims against the collateral in its hands in connection with this liability, because the collateral was pledged for a specific debt of fifteen thousand dollars, and could not have been held for any other.

Until the collateral release contract then, there was no right in the N. Y. bank against the Helena

except to cancel the improper credit. What right, then, had the N. Y. bank after this contract?

The receiver found a fixed account with a fixed credit balance in the N. Y. bank. It does not appear that he knew what these items in the credit balance consisted of, or that the credit balance in tne account remained greater than $2,635 at all times from August 30 until September 4 (which is the essential ground on which the court bases the trust relation in 81 Federal, 602, cited by counsel. In this case too it is apparent, though it does not appear how, that the insolvent bank actually used the money before suspension.) He paid a fixed sum to release these collaterals, making the payment out of the trust moneys, with the approval of the Comptroller. The N. Y. Bank required no adjustment of this item of $2,635 due from it; accepted the sum paid in money without question and unconditionally released the collateral. The release of the collateral is not necessarily a discharge of the debt for which they aie pledged (2 Pingree on Mortgages, Sec. 1228), and it is not alleged here that the debt was discharged. The N. Y. bank may have thought it wise, owing to the intrinsic value of the collateral, (their actual worth is not alleged) to release for $4,000, without demanding adjustment of the $2,635 item. On the other hand, perhaps the Receiver would not have released, nor the Comptroller authorized the release of, the collateral if he had been required to pay $6,635 instead of $4,000. If the court were now to require the Receiver to pay the addi-

tional $2,635, whether from the proceeds of the collateral or from the trust funds, it would be changing the contract and making a new one. This the N. Y. bank could not do, and therefore the plaintiff, in the right of the N. Y. bank, cannot ask. (Sheldon on Subrogation, 2d Ed., Sec. 196). If the contract as made with the N. Y. bank by the Receiver had been that, in addition to paying the four thousand dollars he should assume whatever liabilities there might be to the plaintiff on the part of the N. Y. bank, such a stipulation in the contract would have been a right belonging to the N. Y. bank which it could have enforced and which the plaintiff might have enforced in the right of the N. Y. bank for his own benefit. But no such condition is presented or pleaded here.

It is alleged that the N. Y. bank, when it released the collateral, believed the Helena bank had paid the plaintiff. This shows a mistake of fact on the part of the N. Y. bank. What right did this mistake give it? It was a unilateral mistake, because it is not alleged that the Receiver labored under the same mistake. A mistake of fact on the part of the bank alone would not authorize a court of equity to change the contract as made, but would only be ground for a recission of the contract.

Hearne vs. Mar. Ins. Co., 20 Wall., 490, (22 Co-Op. Ed., 397, left top).

Cases in 15 Am. & Eng. Enc. of Law, p. 631, left middle.

But, if the bank were bringing its own bill to rescind this contract or take advantage of this mistake, it would have to allege, First: That the mistake was *material*, or the moving cause of its action in making the contract. Second: That it was unintentional; that is, that it did not do exactly what it intended to do, having mistaken its effect; and Third: That it was free from negligence, and elected to rescind and offered to return the consideration immediately on discovery of real fact.

Grymes vs. Sanders, 93 U. S., 55. (23 Co-Op. Ed., 801, 802).

15 Am. & Eng. Enc. of Law, pp. 628, 631.

This bill simply alleges the mistake, i. e., that the N. Y. bank believed plaintiff had been paid. [Negligence, indeed, is not only negatived, but is inferentially shown by the allegation concerning the draft given plaintiff upon itself, which it dishonored afterward because of the Helena bank's suspension; and so it ought to have known then and when it made its contract with the Receiver, that the Helena bank had not paid plaintiff, and that the Helena bank could not do business after suspension or make a payment then, which it had not made before. U. S. vs. Knox, 111 U. S. 786; 28 Co-Op. Ed., 603, foot.] Failing to allege these other matters, the bill is fatally defective, viewed from the standpoint of subrogation.

Cases in Am. & Eng. Enc. of Law, p. 633, left, middle.

Romanski vs. Thompson et al., 11 So. Rep., 228, right, top.

Again, plaintiff is not asking for a rescission of this contract, for a rescission must be *in toto*. He cannot affirm the beneficial and reject the injurious parts.

21 Am. & Eng. Enc. of Law, p. 91.

He seeks to let the contract stand, so far as to leave the collateral in the Receiver's hands, which is a benefit to him, in order to hold the trust, and wishes to ignore that feature of the contract which gave the Receiver absolute title in the collateral relieved of all liens. This the N. Y. bank could not do, nor can plaintiff. Moreover, rescission never will be ordered unless the parties could be placed in the same situation as they were before.

93 U. S., 55.

Nor unless the consideration be restored fully.

Columbus R. R. Co. vs. Steinfield, 42 O. St., 449.

Most of appellant's authorities cited under this head, aside from the general definitions of subrogation and trust, assert a principle of law I do not for a moment dispute, i. e., that where a thief, or embezzler, or confidential agent converts stolen property or trust funds into other property, such other property, in the hands of either the thief or of any one else not a bona fide purchaser, will be subject to a trust for the benefit of the real owner. Of this line of authorities are cases in 69 N. Y., 125 Mass., 13 and 58 Cal., and 13 Pa. State.

In every one of these cases the confidential agent or thief had bought the other property, and such other property was in his hands, or in the hands of some one with notice. The principle might be applicable if the N. Y. bank, plaintiff's trustee and confidential agent, had used the $2,635 to pay a debt owing to the First National of Helena, and had released the collateral held by the latter for such debt, which collateral belonged to the N. Y. bank. Such collateral would undoubtedly be subject to a lien in favor of plaintiff, while in the N. Y. bank's hands, or in the hands of others, not purchasers for value without notice. Here the Receiver, who was in no wise trustee or confidential agent of plaintiff, and owed him no duty, used four thousand dollars of his own money to buy an unconditional release of collateral for his trust. He was an innocent purchaser for value of this collateral, since he was not acting in the right of the bank, and was making a new contract of his own with the creditor's funds; and the above principle can have no application to him, for he stands in the attitude of one who has parted with his property to the thief or confidential agent, and the above cases declare that the lien or trust is enforced upon the property that he has not parted with, not what he has innocently received from the thief or agent. On the other hand, even if it had been alleged that the credit of eleven thousand dollars was continuous in a sum greater than $2,635 from August 30 to September 4, was by the N. Y. bank offset against the

$15,000 debt, and both the credit satisfied in full by the Receiver and the debt in full by the bank, and the collateral released on the payment of the four thousand dollars, then the bank, which was plaintiff's confidential agent and trustee, would have used plaintiff's money and the collateral to get what it secured of the Receiver, i. e., the four thousand dollars in cash, and this cash is what the plaintiff's fund would have been converted into by his agent, the N. Y. bank, and on which, under the above rule, plaintiff could enforce his lien. This would be most plain, if, instead of paying the cash to the N. Y. bank, the Receiver had turned over to the N. Y. bank a house and lot in New York city of the value of four thousand dollars. For clearly the lien would then attach under the above authorities, to the house and lot that plaintiff's agent received, and not to what the Receiver got himself thereby. It is clear, then, that the N. Y. bank is not shown to have had, did not, and could not have any such right as would entitle it to claim any preference or trust in any assets in this Receiver's hands. If a third person had bought this collateral of the N. Y. bank for $4,000, it would be impossible to devise a theory upon which plaintiff could assert any lien against it. There being, before the contract, no connection between the deposit creditor on the bank's books and the debt of $15,000, for which the collateral was pledged, the N. Y. bank might have waived its lien altogether on the collateral and given them to

the Receiver without charge, and this would have given the plaintiff no right of action by subrogation. or otherwise against the trust, because the collateral was not security in any way for his claim or for the liability of the N. Y. bank to him.

II.

Right to follow trust funds.

Most vital to this right is the ability to trace the fund in the original or clearly equivalent form into the hands of the person to be charged and the showing that it still remains there.

"Both the settled principles of equity and the weight of authority sustain the view that the plaintiff's right to establish his trust and recover his fund must depend upon his ability to prove that his property is, in its original or substituted form, in the hands of the defendant."

Spokane Company vs. Bank, 68 Fed., 982 foot, and cases.

Bank vs. U. S. Savings Co., 16 Southern, 111 left foot.

"The right has its basis in the right of property. It never was based upon the theory of preference, by reason of an unlawful conversion."

N. Co. vs. Flanders, 58 N. W., 385. (A well considered case, citing many authorities.)

There is no sufficient tracing of the fund.

(*a.*) To negative the possibility of its having been dissipated in the course of business between

the time of payment and suspension it must be averred, if paid direct to the bank, that during the balance of its business life it had that or a greater sum in its vaults.

68 Fed., 980, middle.

And if this is not averred, the presumption is that the contrary condition exists.

11 Southern, 828, right top, supra.

If there was a debit balance in the open account when the $2,635 was credited (and it is nowhere alleged that there was not, but only that there was a credit balance at the date of suspension) as between the two banks, the passing of this sum to the credit of the Helena bank was as much a payment as if the cash had been handed over its counter. It was a mingling of its assets, and no trust results.

Bank vs. Armstrong, 148 U. S., 50 (37 Co-Op. Ed., 148 left middle.

And so, as the payment was made into an account, it should have been alleged that there was a credit balance in the account at the time of payment, and that the credit balance remained equal to or greater than $2,635 to the date of the Helena bank's suspension, else it would have been applied directly in reduction of a debit balance, and have become, as the U. S. Supreme Court says, "a completed transaction," or it might have been dissipated in the remaining four days' business of the Helena bank, and other amounts have replaced it

to make the credit balance as alleged on the last day.

68 Fed., 982, middle.

Merchants Bank vs. Austin, 48 Fed., 25, 29 middle, 30 top, 32 top.

(*b*). It is nowhere distinctly alleged that the $15,000 debt was paid, or that plaintiff's deposit in the N. Y. bank was used to pay it. If it had been, such an equity is too weak.

"But it is the general rule * * that, in order to follow trust funds, * * they must be identified. * * The court below seems to have proceeded upon a supposed equity springing up from the circumstance that, by the application of the fund to the payment of White's creditors, the assigned estate was relieved *pro tanto* from debts which otherwise would have been charged upon it, and that thereby the remaining creditors * * will be benefited. We think it is quite too vague an equity for judicial cognizance."

Bank vs. Dowd, 38 Fed., 172, 184.

The above case was followed and approved in Com. Bank vs. Davis, 20 S. E., 370, 371; and also in Freiburg vs. Stoddard, 28 Atlantic, 1112, 1113, where the court decides, that there is a failure to trace trust funds into specific property, and says, "when the assignor charged these drafts against the accounts of the drawees he cancelled so much of his indebtedness to them, but did not add

a dollar to the fund in bank. It is true his estate was benefited by the transaction, because his indebtedness was thereby reduced. *But as he was insolvent at the time* such benefit to the estate only equalled the pro rata shares which would have been awarded to the drawees on distribution."

In a case where a check deposited for collection was used to adjust balances of the collecting bank in the clearing house, the court says: "As it was, there existed nothing but a cause of action against the bank for conversion of the check, or of the money, its proceeds; and, as such, it stands on the same footing as any other claim upon the assigned assets, based on a conversion of money or other property. To allow such claims to be paid in full out of the assets, when all claims cannot be paid in full, would give a preference to such claims. There is nothing in the insolvent law justifying it."

Westfall vs. Mullen, 59 N. W., 633, 634.

One of the fallacies of appellant lies in assuming that the Receiver used plaintiff's fund, or that his fund was traced into this collateral. The Receiver had no control over that fund; never had assumed or exercised it; the money was in the New York bank; the bank was liable to the plaintiff; was his confidential agent. If plaintiff had sued the N. Y. bank, and the latter had paid the judgment, it would hardly be contended that it could, by reason thereof, have any preferential claim against

this trust; so there is no equity in letting this preference be worked out in this remarkable manner for the benefit of the N. Y. bank at the expense of the general creditors of this insolvent bank, many of whom are doubtless depositors after August 30th, but, who yet could not establish a preference for themselves, unless the insolvency then existing was known to its officers—a fact not existing, because not alleged in this case.

48 Fed., 32, top.

(*c*.) So all deposits with bankers must fall within one of two classes---general or special. Under the custom of banks, Anderson and plaintiff understood that the transmittal and payment under the contract, would not be of specific moneys deposited, but that they would be mingled with the general funds of the N. Y. bank and used, and an equivalent amount paid through a correspondent bank. This then would constitute a mingling of the funds, a loss of their identity so as to prevent a tracing or following as a trust.

148 U. S., 59 foot, 60 top, (37 Co-Op. Ed., 367 right).

Bank vs. Beal, Receiver, 49 Fed., 606.

See also, Sayles vs. Cox, 32 S. W., 626, 627 right top, (which also shows that the allegation of insolvency is immaterial, even where the insolvent bank is the confidential agent or collecting bank.)

(*d*.) Appellant has not alleged any *actual*

knowledge on the part of the Receiver. His contention, then, must be, that knowledge is immaterial. Were this upheld, it would follow that, if the $4,000 received from the Receiver were deposited to the account of John Jones, an innocent customer of the New York bank, who checked it out in a single check to Smith, of Nevada, in payment of a mine, plaintiff could claim a lien on the mine, or follow the proceeds through Smith's hands indefinitely; or, if the Receiver of this bank had in turn exchanged the collaterals or any part of them for any property, plaintiff could hold the other property, any or all of it, or anything into which it was exchanged, or follow the collateral or its proceeds indefinitely, into all hands and in all directions. Such a condition would be a commercial, legal, and equitable impossibility, and the contention cannot stand.

Of cases cited by appellant, the Nurse-Satterlee case would only sustain an endeavor on the part of plaintiff to enforce a trust against the assets of the N. Y. bank, if in the hands of a receiver of that bank—for Satterlee was the receiver of the collecting bank which had deposited the money elsewhere. The Barth case (62 N. W., 94), which is also a case where the insolvent bank was the collecting bank and the confidential agent of the owner of the fund, is a direct adjudication in line with 28 Atl., 68 Fed., and 59 N. W., supra, that a wrongful credit by the N. Y. bank is a conversion giving rise to a cause of action in damages, but not sufficient to warrant a preference, and that, where a

mere credit is employed, the money or fund does not pass so as to be traced within the meaning of the trust doctrine; and as to the user of the credit in reduction of the debt secured by collateral (which was directly and sufficiently alleged and proven in that case) the court says: "It was also *claimed* that the proceeds of the draft had thus been traced into this collateral. * * * *But if the contention is sound that they have been traced into the collaterals* the remedy of the petitioner is manifestly to proceed against them and not against the general assets of the estate." (Italics mine.) The court does not at all decide whether there would be a tracing of the fund under such circumstances. The Standard Oil case, 74 Fed., 395, is one in which the bank received a deposit when hopelessly insolvent, and known to be so to its officers. The depositor filed its claim as a general creditor, and then sued to set aside his election and tendered back his claim on the ground of mistake as to his rights and to obtain a priority for his deposit thus made.

It is earnestly insisted that the pleading does not clearly, distinctly, or at all, disclose any facts warranting any decree to plaintiff against the defendant's trust, and that the judgment of the court below must be affirmed.

Respectfully submitted,

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Attorney for Appellee.